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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1944.

No. 1346 108

HARRY EDISON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI
To the United States Circuit Court of Appeals
for the Eighth Circuit
and
BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI

To the United States Circuit Court of Appeals for the Eighth Circuit.

To the Honorable Supreme Court of the United States:

The petitioner, Harry Edison, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Eighth Circuit affirming the judgment of the Tax Court of the United States in the cause styled "Harry Edison, Petitioner, v. Commissioner of Internal Revenue, Respondent."

JUDGMENT AND APPLICATION FOR CERTIORARI.

The judgment of the United States Circuit Court of Appeals was entered on April 23, 1945 (R. 78), and this petition is filed within three months thereafter.

SUMMARY STATEMENT OF FACTS.

On May 24, 1938, petitioner created two trusts which by their terms were irrevocable (R. 8-25). One was for the benefit of petitioner's son, Sidney J. Edison, and his issue. The other was for the benefit of petitioner's daughter, Edna L. Edison, and her issue. No right of reverter was retained by the petitioner. The trustee was directed to pay over all or such portion of the net income as the trustee deemed advisable or necessary to the child for whose benefit the trust was created during his or her lifetime for such child's comfort, support, education or care. Any portion of the net income not thus paid over was to be added to the corpus. If the trustee deemed it advisable or necessary for the greater ease or comfort or for the business training of such child or to help such child start in business or some other vocation or profession or for such child's education, maintenance or care to encroach upon the corpus of the trust, the trustee was authorized to pay over all or such portion of the trust as the trustee should deem advisable or necessary for such purpose. Upon the death of the child, the corpus is to go to his or her issue (R. 9-12, 17-19).

The Sidney J. Edison trust provides that should he die without issue then the corpus is to go to his sister, Edna L. Edison, and upon her death is to go to her issue. If she dies without issue, then to her heirs at law. If Sidney J. Edison should leave no issue and his sister should have predeceased him without leaving issue surviving her, then the corpus is to go to the heirs at law of Sidney J. Edison.

The Edna L. Edison trust provides that should she die without issue then the corpus is to go to her brother, Sidney J. Edison, and upon his death is to go to his issue. If he dies without issue, then to his heirs at law. If Edna L. Edison should leave no issue and her brother should have predeceased her without leaving issue surviving him, then the corpus is to go to the heirs at law of Edna L. Edison.

The Edna L. Edison trust further provides that until she attains her majority the trustee should permit the net income of said trust to accumulate and as it accumulates it should become part of the corpus of the trust.

Petitioner retained no right to receive any part of the income or corpus of the trust.

The son was in his twenty-third year at the time, and the daughter in her eighteenth year. Petitioner was a resident of Missouri. The son had his residence in New York and was married in 1940. The daughter was unmarried during the period involved and had her home with her parents (R. 37).

The trusteed property consisted almost wholly of shares of capital stock in Edison Brothers Stores, Inc., a Delaware corporation, which was engaged in the operation of retail shoe stores throughout the United States but had its principal offices in St. Louis, Missouri, and of which petitioner was the president, a director, and a large stockholder (R. 36). The stock was listed on the New York Stock Exchange. Prior to the creation of the trusts, petitioner was the owner of 40,576 shares of the total 385,490 shares of common stock which the corporation had outstanding, and of 50 shares of the total of 60,000 shares of outstanding preferred stock. He originally put a total of 5,000 shares of the common stock into the two trusts and later added another 2,500 shares to the son's trust and 2,000 shares to the trust for the daughter (R. 37).

Petitioner named himself as the initial trustee and provided for successor trustees. He, also, reserved the right to designate trustees to serve in lieu of those named (R. 8, 14, 17, 22).

He vested the trustees with broad administrative powers (R. 13, 21, 22).

Petitioner reported the gifts to the trusts in gift tax returns for the years in which the gifts were made (R. 38).

During the taxable years involved the capital stock, both common and preferred, of Edison Brothers Stores, Inc., was listed on the New York Stock Exchange. During all of said years petitioner was president and a director of the Company.

Petitioner acted as sole trustee under each trust during the years involved. For each of the taxable years 1938 to 1941, inclusive, petitioner filed a fiduciary income tax return for each of the trusts, and as trustee paid taxes on the amount of the undistributed income. The income received by petitioner as trustee of these trusts was kept by him in separate bank accounts (R. 38, 39).

There has been compliance with all conditions required to protect the Government against having to refund the taxes paid by the trustee in the event petitioner should prevail in this proceeding (R. 43).

Respondent included all of the income of the two trusts as a part of petitioner's income from the years 1938 to 1941, inclusive, and determined deficiencies in petitioner's tax for said years in the amounts hereinbefore stated.

Thereupon, petitioner filed with the Tax Court of the United States his petition for a redetermination of said deficiencies and the Tax Court held that the trust income was taxable to petitioner within the doctrine of Helvering v. Clifford, 309 U. S. 331, under Section 22 (a) of the Internal Revenue Code and sustained the Commissioner's determination of deficiencies (R. 44-52). (The decision was not reviewed by the full Tax Court.)

DECISION OF LOWER COURT.

The Court of Appeals affirmed the decision of the Tax Court asserting that it could not say that the Tax Court's appraisal of petitioner's powers is without a rational basis of taxability under section 22 (a) and wholly arbitrary (R. 66-77).

JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925, Chapter 229, 43 Stat. 939, 28 U. S. C. A. 347. Helvering v. Clifford, 309 U. S. 331; Helvering v. Stuart, 317 U. S. 154.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED.

The 5th Amendment to the Constitution of the United States provides:

> "No person shall be held to answer for a capital or otherwise infamous crime unless on a presentment or indictment of a grand jury * * * nor be deprived of life, liberty or property without due process of law; * * *"

The 16th Amendment to the Constitution of the United States provides:

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

26 U. S. C. A., Internal Revenue Code, Section 22 (a), provides:

"Sec. 22. Gross income.

"(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transactions of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

26 U. S. C. A., Internal Revenue Code, Section 161, provides:

"Sec. 161. Imposition of tax.

"(a) Application of Tax.—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including— * * *

"(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

"(b) Computation and Payment.—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor)."

26 U. S. C. A., Internal Revenue Code, Section 162, provides as follows:

"Net Income.

"The net income of the estate or trust shall be com-

puted in the same manner and on the same basis as in the case of an individual, except that— * * *

"(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary;

"(d) Rules for Application of Subsections (b) and (c)—For the purposes of subsections (b) and (c)—

"(1) Amounts distributable Out of Income or Corpus.—In cases where the amount paid, credited, or to be distributed can be paid, credited, or distributed out of other than income, the amount paid, credited, or to be distributed (except under a gift, bequest, devise or inheritance not to be paid, credited, or distributed at intervals) during the taxable year of the estate or trust shall be considered as income of the estate or trust which is paid, credited, or to be distributed if the aggregate of such amounts so paid, credited, or to be distributed does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts so paid, credited, or to be distributed during the taxable year of the estate or trust in such cases exceeds the distributable income of the estate or trust for its taxable year, the amount so paid, credited, or to be distributed to any legatee, heir, or beneficiary shall be considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of such distributable income as the amount so paid,

credited, or to be distributed to the legatee, heir, or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to legatees, heirs, and beneficiaries for the taxable year of the estate or trust. * * *"

26 U. S. C. A., Internal Revenue Code, Section 167 (c), provides:

"Income of a trust shall not be considered taxable to the grantor under sub-section (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. * * *"

QUESTION PRESENTED.

Is the income of irrevocable trusts taxable to the grantor under 26 U. S. C. A., Internal Revenue Code, Section 27 (a), where the grantor

(a) retained no right to share in the income or corpus of the trusts,

(b) created such trusts for the benefit of his son and daughter and their issue and appointed himself as the initial trustee,

(c) acted as such during the years in question,

(d) vested in the trustee broad powers of management and investment,

(e) directed the trustee to pay over to the primary beneficiary for whom the trust was created during his or her lifetime all or such portion of the net income of the trust as the trustee in his uncontrollable discretion should think advisable or necessary for the comfort, support,

education or ease of said primary beneficiary and provided that any portion of the income not thus paid over should be added to the corpus of the trust fund,

(f) provided in the trust instruments that, if in the uncontrollable discretion of the trustee, the trustee should deem it advisable and necessary for the greater ease or comfort of the primary beneficiary or for his or her business training or to help him or her start in business or some other vocation or for his or her education, maintenance or care to encroach upon the corpus of the trust for the benefit of the primary beneficiary and pay over such portion thereof as the trustee shall deem advisable or necessary, and

(g) reserved the right to designate a trustee or trustees to act in lieu of those appointed trustees under the trust instruments,

and where the son was twenty-three years old when the trust was created and the daughter attained her majority during the last taxable year in question and no part of the income or corpus was paid her or used for her benefit during her minority?

REASONS RELIED UPON FOR GRANTING THE WRIT.

(a) To tax petitioner in this case on the income of the trusts involved is in violation of the Constitution of the United States and the Amendments thereto, particularly Art. I, Sec. 2, Cl. 3, and Sec. 9, Cl. 4 of the original Constitution and the Fifth and Sixteenth Amendments to the Constitution.

(b) The decision of the Circuit Court of Appeals for the Eighth Circuit is in direct conflict with the decisions of this Court in Helvering v. Stuart, 317 U. S. 154, wherein

this Court held that broad powers of management in trustees, even though without adverse interests, point to complete divestment of control as does the impossibility of reversion to the grantors, and further held that economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme and that the non-material satisfactions (gifts—contributions) of the donor are not taxable as income; Eisner v. Macomber, 252 U. S. 189, which held that income to be taxable under the Sixteenth Amendment must be gain derived by the taxpayer for his separate use, benefit and disposal; Hoeper v. Tax Commission, 284 U. S. 206, and Heiner v. Donan, 285 U. S. 312, wherein the court held it to be a denial of due process of law to tax one person upon the gain and profits of another and condemned such exaction as spoliation, not taxation, and Reinecke v. Northern Trust Co., 278 U. S. 339, wherein this court held that the settlor of a trust did not save to himself any control over the economic benefits or the enjoyment of the property which he conveyed to a trust where he reserved to himself (as settlor) the power to supervise the investment of the trust funds, to vote any shares of stock held by the trustee, to control all leases executed by the trustee and to appoint successor trustees.

(c) The decision of the Circuit Court of Appeals for the Eighth Circuit is in direct conflict with the following decisions:

1. The decisions of the Circuit Court of Appeals for the Seventh Circuit in Commissioner v. Katz, 139 Fed. (2d) 102, and Commissioner v. Armour, 125 Fed. (2d) 467, in which cases the facts are almost identical in all respects with those in the case at bar;

2. The decisions of the Circuit Court of Appeals for the Tenth Circuit in Jones v. Norris, 122 Fed. (2d) 6, and

Armstrong v. Commissioner, 143 Fed. (2d) 700, in which cases the facts are very similar to those present in this case;

3. The decision of the Circuit Court of Appeals for the First Circuit in Commissioner v. Branch, 114 Fed. (2d) 985, holding that broad powers of control as trustee do not make a grantor taxable with the income of the trust created by him; and

4. The decision of the Circuit Court of Appeals for the Second Circuit in Phipps v. Commissioner, 137 Fed. (2d) 141.

(d) The decision is in direct conflict with the provisions of 26 U. S. C. A., Internal Revenue Code, Sections 161, 162 and 167 (c); and

(e) The question involved is one of great public importance. If the decision of the Court of Appeals for the Eighth Circuit is not reversed a great injustice will be done to many taxpayers who conveyed portions of their property to trusts, retained no possible economic enjoyment of any part of the income or corpus thus conveyed and are now confronted with taxation on the income therefrom, a result which might bankrupt some of them. In creating these trusts they relied upon the decisions of this Court and of the Circuit Courts of Appeal of various circuits and also upon the following decisions of the United States Tax Court which had been reviewed by all sixteen members of that Court and in which the Commissioner had acquiesced, to-wit:

Ayer v. Com., 45 B. T. A. 146;
Lowenstein v. Com., 3 T. C. 1133;
Small v. Com., 3 T. C. 1142;
Cherry v. Com., 3 T. C. 1171;
Banfield v. Com., 4 T. C. 29.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals, Eighth Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 13,014, Harry Edison, Petitioner, v. Commissioner of Internal Revenue, Respondent, and that the said judgment of the United States Circuit Court of Appeals may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

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Attorney for Petitioner.

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vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

OPINIONS BELOW.

The findings of fact and opinion of The Tax Court (R. 44-52) are not officially reported since same were issued as a Memorandum Findings of Fact and Opinion.

The opinion of the Circuit Court of Appeals (R. 66-77) is not yet reported.

JURISDICTION.

The jurisdictional statement appears in the Petition for the Writ of Certiorari.

STATEMENT OF THE CASE.

Petitioner's statement of the case appears in the Petition for the Writ of Certiorari.

ARGUMENT.

I.

To Tax Petitioner in This Case on the Income of the Trusts Involved Is in Violation of the Constitution of the United States and the Amendments Thereto, Particularly Art. I, Sec. 2, Cl. 3, and Sec. 9, Cl. 4, of the Original Constitution and the Fifth and Sixteenth Amendments to the Constitution.

What the respondent is contending for is the right of the Government, in the guise of an income tax, to levy a privilege tax on the right of a grantor to act as trustee for his issue. It is assumed that if the same powers were vested by the donor in a third party trustee, the donor would not be taxable on the income of such a trust. The respondent has lost sight of the fundamental basis upon which income tax rests and the constitutional and statutory provisions in regard thereto. It therefore behooves us to consider the constitutional and statutory provisions pertaining to income tax so that we may orient ourselves properly.

The Sixteenth Amendment grants Congress the power to lay and collect taxes on income from whatever source derived without apportionment among the several states and without regard to any census or enumeration. This amendment takes income taxes out of the apportionment provision of Article I, Section 2, Clause 3, of the Constitution, which provides that direct taxes shall be apportioned among the several states according to their respective numbers.

This Court in Eisner v. Macomber, 252 U. S. 189, held that income to be taxable under the Sixteenth Amendment must be gain derived by the taxpayer for his separate use, benefit and disposal, and in Helvering v. Stuart, 317 U. S. 154, said on page 168:

> "Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme. * * * The 'non-material satisfactions' (gifts—contributions) of a donor are not taxable as income."

From this quotation it is clear that gain realized by a trustee of an irrevocable trust from trust property to be used for the benefit of the beneficiaries of the trust may be taxable to the trustee in his trust capacity or to the beneficiaries who receive the benefit therefrom, but it is not taxable to the donor in his individual capacity unless the donor has reserved to himself as donor such rights and powers in the property as would still leave him the owner thereof.

Keeping in mind the foregoing it is easy to understand the decisions of this Court in **Helvering v. Horst**, 311 U. S. 112, and **Helvering v. Clifford**, 309 U. S. 331.

In the Horst case the owner of negotiable bonds in 1934 and 1935 detached from them negotiable interest coupons shortly before the due date and delivered them as a gift to his son, who, in the same year, collected them at maturity. The Court held that the owner of the bonds was taxable with the interest collected on the coupons which he detached and gave to his son because he who owns or controls the source of the income also controls the disposition of that which he could have received himself or diverted to others as the means of procuring the satisfaction of his wants.

In the Clifford case the taxpayer declared himself trustee of certain securities which he owned. The trust was for a term of five years, except that it would terminate earlier on his death or the death of his wife. On the termination of the trust the entire corpus was to go to taxpayer. During the continuance of the trust he was to pay over to his wife the whole or such part of the net

income as he in his absolute discretion might determine. It was held by the court that as a matter of law it could not conclude that respondent ceased to be the owner of the corpus after the trust was created. There was at best a temporary reallocation of income within an intimate family group.

The logic that runs through both cases is that the taxpayer never parted with ownership of the tree from which the fruit was gathered and, since he owned the tree, the ownership of the fruit which grew thereon would be attributed to him.

In the case at bar the petitioner parted absolutely with all right, title and interest in the corpus of the trust. There was no temporary severance of the fruit from the tree while he remained owner of the tree. There was a permanent and final disposition of the trust property and all rights therein vested in others. No right of reverter was retained. Both in substance and in form there had been a complete disposition of the property by him and all income therefrom. Whatever powers in regard to the property he might exercise thereafter were only exercisable by him as trustee and for the benefit of the trust. Never could he receive the benefit of any income therefrom. The petitioner in fact and in law limited his individual rights when he named himself as the first trustee and acted as such because he could not deal with himself as trustee, whereas, had he named a third party trustee, he could have dealt with such trustee. Whatever power he exercised over the property was appendant to his office of trustee and was controlled by the principles of law applicable to the conduct of trustees. No benefits could be derived by himself personally from any income from or increment to the corpus because no right of reversion was retained in the trust property. All the income was to go to a designated group of individuals and to no one else.

No rights were retained by him as donor except as to the naming of successor trustees. The right to name successor trustees is not the equivalent of ownership. No economic benefit could result therefrom. No one would argue that such a right, if vested in a person other than the donor, would make such person the owner of the property.

It is apparent that to tax petitioner in this case on the income of this trust would be in violation of the Constitution of the United States and the Amendments thereto, particularly Art. I, Sec. 2, Cl. 3, and Sec. 9, Cl. 4, of the original Constitution and the Fifth and Sixteenth Amendments to the Constitution because it would be a denial of due process of law to tax one person upon the gains and profits of another. Such exaction has been condemned by this Court as spoliation, not taxation. Hoeper v. Tax Commission, 284 U. S. 206, and Heiner v. Donan, 285 U. S. 312.

II.

The Decision of the Circuit Court of Appeals for the Eighth Circuit in This Case Is in Direct Conflict With Decisions of the United States Supreme Court.

The decision of the Circuit Court of Appeals in this case conflicts with the decision of this Court in Helvering v. Stuart, 317 U. S. 154, wherein this Court held that broad powers of management in trustees, even though without adverse interests, point to complete divestment of control, as does the impossibility of reversion to the grantors, and further held that economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme and that the non-material satisfactions (gifts—contributions) of the donor are not taxable as income, and wherein this Court held that, disregarding the minority of some of the beneficiaries, the power vested in the trustees, including the grantor-trustee,

to distribute or accumulate income within their discretion would not make the income taxable to the grantor (l. c. 167-168). The language of this Court used in the decision has apt application to the facts of this case and we take the liberty of quoting same:

> "In the John Stuart trusts the trustees, in their discretion, were to distribute income to the named beneficiaries for fifteen years and thereafter to distribute the entire net income. In the Douglas Stuart trusts, the directions authorized discretionary distribution to the beneficiaries or its application to their education, support and maintenance until the children reached the age of twenty-five years. Undistributed portions of the income were to be added to the corpus. Plainly, these distributions or accumulations were to be used for the economic advantage of the children of the settlors and to the amount of these distributions and accumulations would satisfy the normal desire of a parent to make gifts to his children. Is this alone sufficient to make the income of the trusts taxable to the settlors?
>
> "Disregarding for the moment the minority of some of the beneficiaries, we think not. So broad a basis would tax to a father the income of a simple trust with a disinterested trustee for the benefit of his adult child. No act of Congress manifests such an intention. Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme. That gain need not be collected by the taxpayer. He may give away the right to receive it, as was done in Helvering v. Horst, 311 U. S. 112, 61 S. Ct. 144, 85 L. Ed. 75, 131, A. L. R. 655; Helvering v. Eubank, 311 U. S. 122, 125, 61 S. Ct. 149, 150, 85 L. Ed. 81, and Harrison v. Schaffner, 312 U. S. 579, 61 S. Ct. 759, 85 L. Ed. 1055. But the donor nevertheless had the 'use (realization) of his economic gain.' 311 U. S., at page 117, 61 S. Ct., at page 147, 85 L. Ed. 75, 131 A. L. R. 655. In none of the cases had the taxpayer really disposed of the res

which produced the income. In Corliss v. Bowers, 281 U. S. 376, 50 S. Ct. 336, 74 L. Ed 916, he had disposed of the res, but with a power to revoke at any moment. This right to realize income by revocation at the settlor's option overcame the technical disposition. The 'nonmaterial satisfaction' (gifts—contributions) of a donor are not taxable as income. Helvering v. Horst, supra."

It also conflicts with the decision of this Court in Reinecke v. Northern Trust Co., 278 U. S. 339, wherein this Court held that the settlor of a trust did not save to himself any control over the economic benefits or the enjoyment of the property which he conveyed to a trust where he reserved to himself (as settlor) the power to supervise the investment of the trust funds, to vote any shares of stock held by the trustee, to control all leases executed by the trustee and to appoint successor trustees.

III.

The Decision of the Court of Appeals for the Eighth Circuit in This Case Is in Direct Conflict With the Decisions of Courts of Appeals of Other Circuits.

The Circuit Court of Appeals for the Seventh Circuit in Katz v. Commissioner, 139 Fed. (2d) 107, in which case the facts were almost identical with those in the case at bar, held that the grantor was not taxable on income of the trust which he had created. In that case he appointed himself sole trustee, conveyed to the trust stock of a corporation of which he was president and of which he owned one-fourth of its outstanding capital stock, vested the trustee with the broadest powers and provided that the trustee should not be liable for any loss incurred by the trust estate and vested the trustee with the right in his discretion at any time and from time to time to withhold and accumulate any of the net income payable to

the beneficiaries or apply any or all of the net income for the benefit of the beneficiaries. The taxpayer was a man of considerable means and had a very large annual income. As trustee he was given full power and authority to manage and control the corpus of the trust estate and also any accumulated income therefrom in such manner as he deemed advisable and as though he were the owner thereof, including the power to invest without regard to the normal restrictions on investment of trust funds and also the right to vote all shares of stock held by the trust. He was authorized to evaluate all distributions and make the same in kind or in cash. He provided that no trustee should be liable for any loss or damage incurred by the trust estate except that caused by wilful default or misconduct. The trust instrument also contained a spendthrift trust provision so that no beneficiary had the right to anticipate or alienate his interest in the trust. The provisions of the trust instrument are set forth in the decision of the Board of Tax Appeals which was affirmed. 46 B. T. A. 187. The opinion of the Circuit Court of Appeals in part is as follows:

> "We agree with the Board that the instant case is distinguishable from the Clifford case. True, there are some elements in common, most noticeable of which are the broad powers of management vested in the trustee. Such matters of similarity, however, are of little consequence and certainly not controlling when considered in connection with other provisions, which, in our judgment, clearly remove the instant situation from the rationale of the Clifford case. The trust in Clifford was of short duration, while in the instant case it is long term in character, having an indefinite and at all times unascertainable duration. Of course, the trust duration is not conclusive, but it is a significant circumstance. Retention by the grantor of economic benefit is more readily attributable in a trust of short term duration. Under the cir-

> cumstances of the Clifford case, conspicuous among which was a short term trust, the Court concluded that there was 'but a temporary reallocation of income.' On the other hand, in the instant case, both the income and corpus, due largely to the long term nature and indefinite existence of the trust, amount to a final disposal which may be characterized as permanent. In Clifford, the trust property was to be returned to the donor in a comparatively short period, while here it will never be returned, except on the contingency of revocation, hereinafter discussed in connection with Sec. 166."

The Circuit Court of Appeals for the Seventh Circuit came to a similar conclusion in the case of Commissioner v. Armour, 125 Fed. (2d) 467. In that case the petitioner created a trust for the benefit of her daughter, who was an adult. The petitioner designated herself as sole trustee. The trustee was charged to pay to her daughter all income and such part of the principal as should be necessary during the daughter's lifetime for the daughter's support, maintenance and comfort. Upon the death of the daughter all the remaining part of the trust estate was to be delivered to the mother, if living, and if not to her estate. The daughter had no right to assign, transfer or encumber the trust estate or its income. The trust instrument provided that the trustee should have as full and unlimited power and discretion as if said trust property were her own absolute estate, not limiting the trustee to such investments as trustees are by law authorized to make, but giving her full power to make and retain any other investments which she might deem advisable. The trustee could purchase and hold as an investment for the trust estate property of any kind, character, nature and description. The court held that the income was not taxable to the grantor under Section 22 (a). It reviewed the Clifford case and the cases which stemmed from it.

The decision in this case is in conflict with two decisions handed down by the Circuit Court of Appeals for the Tenth Circuit, to-wit: Jones v. Norris, 122 Fed. (2d) 6, and Armstrong v. Commissioner, 143 Fed. (2d) 700.

In Jones v. Norris, a much-cited case, the grantor created trusts for the benefit of his children, reserved to himself the right during his lifetime to order the trustee to make settlement in full or in part with any one of the beneficiaries after such one had attained the age of twenty-one years and to order and direct that a certain part of the net income from any one of the trust estates created by him to be paid to the beneficiary. He also reserved to himself full power of control and management over the trust estate and the right to change the trustee. He named his confidential employee as trustee. The court held that under Section 22 (a) as liberally construed by Helvering v. Clifford taxation to the grantor depends upon whether or not the grantor after the trust has been established may still be treated as the owner of the corpus. It then held that the rationale of the Clifford case did not bring the facts before the court within the taxing scope of Section 22 (a).

In Armstrong v. Commissioner, supra, the Court of Appeals was confronted with facts which were very similar to those present in the case at bar and it ruled that the grantor was not taxable on the income of the trust, though he named himself as sole trustee, vested himself with the broadest powers of management and after providing that the net income was to be accumulated during the period of the trust then further provided that he could pay over any portion of the income or corpus to the beneficiaries at any time deemed advisable by the trustee. These powers are set forth more particularly in the opinion of the Tax Court, which was affirmed by the Court of Appeals, 1 T. C. 1008, l. c. 1010-1011.

In Commissioner v. Branch, 114 Fed. (2d) 985, the Circuit Court of Appeals for the First Circuit held, l. c. 987:

> "* * * Where the grantor has stripped himself of all command over the income for an indefinite period, and in all probability, under the terms of the trust instrument, will never regain beneficial ownership of the corpus, there seems to be no statutory basis for treating the income as that of the grantor under Section 22 (a) merely because he has made himself trustee with broad power in that capacity to manage the trust estate."

The decision in this case is also in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in Phipps v. Commissioner, 137 Fed. (2d) 141.

The Court of Appeals in its decision in the case at bar implied that control of the trust stock, together with that which the grantor continued to hold individually, might well have been of supreme importance to his economic welfare.

We wish to remark that the trust instrument nowhere gives the trustee the specific right to vote trust stock. Therefore any right to vote trust stock would flow from the fact that the law vests trustees with the power to vote entrusted shares, if nothing is said in the trust instrument to the contrary. If the rights exists to vote the entrusted shares because nothing is said in the trust instrument in regard thereto, such shares can only be voted in a lawful manner, that is, for the sole benefit of the trust estate. Never can such shares be lawfully voted to the detriment of the trust estate. The power to vote the stock is incidental. It arises from the fact that among the trust assets are shares of stock. The trusts were not created to enable the grantor to vote the shares of stock. That power he possessed before he gave the shares away. His authority to act under the trusts was as trustee, not as grantor. The

trusts were created for the benefit of his children and their issue and not for any benefit that he could personally derive therefrom. Benjamin Lowenstein, 3 T. C. 1133. Secondly, stockholders only elect directors. It is the directors who choose the president, not the stockholders. Consequently it is erroneous to state that the salary received as president can be attributed to the voting of the stock.

Congress when it enacted Sections 161 and 167 of the Internal Revenue Code and provided that grantor-trustees shall not be taxable with the income of the trusts except under the limited circumstances set forth must have had in mind that in these modern times trusts would no doubt have in their portfolios shares of stock and that grantors of such trusts would frequently transfer to the trusts stock of corporations in which they were personally interested as large stockholders, directors or officers, because it is only a natural thing for them to do so. Of course, the fact that the petitioner owned approximately 10% of the common stock and less than one per cent of the preferred stock of the company of which he was president and a director prior to the time he made any gifts of the common stock to the trusts, all of which gifts aggregate less than 25% of the shares owned by him certainly could not make the income of the trusts taxable to him. Ownership of that small portion of the stock could not give him control. Again and of supreme importance is the fact that if his voting of that stock resulted in his receiving some economic gain as an individual, the Government was taxing that economic gain. Thus if it be, for the sake of argument, conceded that the voting of the stock enabled him to become president of the company and receive a salary as such and thereby derive an economic gain as an individual, the Government was collecting a tax thereon from him as an individual because he had to include that salary in his personal income tax return. The trust would account for the economic gain which it derived and, as just stated, he

would personally account for the economic gain derived by him as an individual.

IV.

The Decision of the Circuit Court of Appeals for the Eighth Circuit in This Case Is in Direct Conflict With the Provisions of 26 U. S. C. A., Internal Revenue Code, Sections 161, 162 and 167 (c).

The fact that the grantor acting as trustee may in his discretion either distribute income to the beneficiaries or accumulate same should not be taken into consideration in determining whether or not a grantor is taxable with the income of the trust. This is so because Congress has specifically declared in Section 161 of the Internal Revenue Code that the income which in the discretion of the fiduciary may be either distributed to the beneficiaries or accumulated shall be taxable to the trust except insofar as same may have been distributed and in Section 167 (c) has provided that the income of a trust shall not be considered taxable to the grantor under Section 167 (a) or any other provision of the Internal Revenue Code, including, of course, Section 22 (a), merely because such income, in the discretion of the grantor acting as trustee, may be applied or distributed for the support or maintenance of a beneficiary, except to the extent that such income is so applied or distributed. Consequently we must find the elements which would afford a proper basis for taxing the income of a trust to the grantor in the other provisions of the trust instrument, to-wit, broad powers of management and investment.

In this respect, as we have pointed out heretofore, it has been uniformly held by this Court and the Courts of Appeals of other Circuits that broad powers of management and investment do not make the income of a trust

taxable to the grantor even though he appoints himself trustee.

V.

The Question Involved Is One of Great Public Importance and If the Decision of the Court of Appeals for the Eighth Circuit Is Not Reversed a Great Injustice Will Be Done to Many Taxpayers Who Conveyed Portions of Their Property to Trusts, Retained No Possible Economic Enjoyment of Any Part of the Income or Corpus Thus Conveyed and Are Now Confronted With Taxation on the Income Therefrom, a Result Which Might Bankrupt Some of Them. In Creating These Trusts They Relied Upon the Decisions of This Court and of the Circuit Courts of Appeal of Various Circuits and Also Upon Decisions of the United States Tax Court Which Had Been Reviewed by All Sixteen Members of That Court and in Which the Commissioner Had Acquiesced.

The result obtained by the Commissioner in this case lays the foundation for what might become a vicious practice. The full Tax Court in a line of decisions extending over a period of years has ruled in cases similar to the one at bar that the grantor-trustee is not taxable with the income of a trust created by him where the facts are similar to those in this case.

Ayer v. Commissioner, 45 B. T. A. 146 (acquiesced in by Commissioner, 1942, 1 C. B. 2);

Lowenstein v. Commissioner, 3 T. C. 1133 (acquiesced in by Commissioner, 1944 Ruling No. 1944-18-11847);

Small v. Commissioner, 3 T. C. 1142 (acquiesced in by Commissioner, 1944 Ruling No. 1944-20-11863);

Cherry v. Commissioner, 3 T. C. 1171 (acquiesced in by Commissioner, 1944 Ruling No. 1944-21-11872);

Banfield v. Commissioner, 4 T. C. 29 (acquiesced in by Commissioner, 1944 Ruling No. 1944-23-11896.

These were decisions which were reviewed by all sixteen members of the Tax Court. No appeals were taken by the Commissioner, but, on the contrary, the Commissioner announced his acquiescence in same and therefore they became guides to the public and members of the bar for future action.

In every edition of the Internal Revenue Bulletin of the Treasury Department the Commissioner makes the following statement:

> **"Announcement Relating to Decisions of the Tax Court of the United States, Formerly Known as the United States Board of Tax Appeals.**
>
> "In order that taxpayers and the **general public** may be informed whether the Commissioner has acquiesced in a decision of The Tax Court of the United States, formerly known as the United States Board of Tax Appeals, disallowing a deficiency in tax determined by the Commissioner to be due, announcement will be made in the semi-monthly Internal Revenue Bulletin at the earliest practicable date. (No announcements are made in the Bulletin with respect to memorandum opinions of The Tax Court.) Notice that the Commissioner has acquiesced or non-acquiesced in a decision of The Tax Court relates only to the issue or issues decided adversely to the Government. **Decisions so acquiesced in should be relied upon by officers and employees of the Bureau of Internal Revenue as precedents in the disposition of other cases.**" (Emphasis ours.)

In the case at bar, a single member of the Tax Court in his decision departed from the rule announced previously and held contrary to the decisions aforementioned. This

resulted in an appeal on the part of the taxpayer. In the Court of Appeals the Commissioner urged that the Tax Court's determination is binding unless lacking warrant in the record, and the Circuit Court of Appeals held that under the rule of Dobson v. Commissioner, 320 U. S. 489, its function was simply to check whether the appraisal which the Tax Court had made of the elements and incidents of control and of command of income in relation to the terms, circumstances, relationships, object and effect of the particular dedication (creation of the Trust) is wholly arbitrary. As a result you have the decision of a dissident member become the established rule of law contrary to the principles announced by the full Tax Court. In the future the Tax Court will have to follow the decision of the Court of Appeal under our system of legal procedure. The taxpayers are helpless. If the decision is favorable to the taxpayer and against the Government, the Commissioner need do nothing. Therefore, there is no opportunity on the part of the taxpayer to have that decision of the Tax Court approved by the Circuit Court of Appeals and get the benefit of the application of the rule in the Dobson case. The Commissioner can lay back and wait until he has prevailed upon some member of the Tax Court to reach a contrary conclusion (one favorable to the Government), and if the presiding judge of the Tax Court fails to order said decision reviewed by the full Tax Court the taxpayer is then compelled to take an appeal and the Commissioner then resorts to the rule in the Dobson case. As a consequence you have principles become the supreme law of the land which are contrary to the principles announced in well considered opinions of the full Tax Court.

Without a doubt based upon the aforementioned decisions of the full Tax Court and the acquiescence of the Commissioner therein a good number of trusts were created and grantors irrevocably changed their positions in

reliance thereon. They created trusts, made gifts of property to the trusts and were led to believe by these decisions and these acquiescences that they were not taxable with the income therefrom if they came within the purview of these decisions. For the Commissioner several years later to attempt to tax grantors, who acted in reliance upon his acquiescence in the Ayer case and in the other aforementioned cases, on the income of the trusts created by them would not only create intolerable hardships, but would constitute an act of gross injustice. It might lead to the bankruptcy of some grantors for the present rates of taxation on income are so high that to add to the gross income for tax computation purposes income which such grantors do not actually have the benefit of might lead to results where such grantors are compelled to pay more in income taxes to the Government than the total income received by them and it might eat up in the course of a very few years all of their capital. It has ever been the rule of courts that the principles of decisions of courts upon which action has been taken, particularly where administrative departments have acquiesced therein, are rules of property and only under extreme circumstances will the principles of such decisions be disregarded.

As stated in 59 C. J., 1029-1030:

> "The courts are reluctant to overthrow a long-followed executive construction of a statute where to do so would work injustice, unsettle titles, or prejudice persons who have acquired contract or property rights in reliance on such construction and the executive construction will control under such circumstances, unless it is manifestly wrong, or unless some great public measure, benefit, or right is involved, and some authorities have held that such a construction will be followed even though erroneous."

In view of the foregoing rule, it follows a fortiori that, if the executive construction is in itself based upon a judicial construction, much greater weight must be attached to such executive construction and greater hesitancy must be exercised in prejudicing irrevocable action taken in reliance thereon.

Congress enacted the Revenue Act of 1942 after the Ayer case was decided and acquiesced in by the Commissioner, all of which tends to give additional force to the acquiescence of the Commissioner and has the effect of the adoption by Congress of the interpretation of the Act theretofore made, since there was no change in the wording of Section 22 (a) of the previous Revenue Act. This well-settled principle of statutory construction is set forth in 59 C. J. 1030, as follows:

> "Executive construction is entitled to additional weight where it has been impliedly indorsed by the legislature, as by the re-enactment of the statute, or the passage of a similar one, in the same or substantially the same terms, or by failure of the legislature, with knowledge of such construction, to change the law or adopt amendments urged."

Petitioner created the trusts in this case on May 24, 1938. Prior thereto Phoebe Warren McKean Downs had been decided by the Board of Tax Appeals on December 9, 1937, 36 B. T. A. 1129, and had been acquiesced in by the Commissioner, 1938-1 C. B. 9. In that case the grantor had reserved the power to alter the distributive shares of principal and income of the beneficiaries of the classes named in the trust instrument. It was held that the grantor was not taxable with the income of the trust. Furthermore the petitioner relied upon Sections 161 and 167 of the Internal Revenue Code.

The Circuit Court of Appeals in its decision in this case

states that unusually broad powers were granted to the trustee in the trust instruments with which we are concerned. The powers therein contained are in reality the customary powers given to trustees and the Tax Court in many cases which have come before it has recognized same as such. See J. O. Whiteley, 3 T. C. 1265. They appear in standard legal form books which have been published in the last forty years in almost the same language as used in these trust instruments.

In Vol. 2, Scott on Trusts (Austin Wakeman Scott, Dane Professor of law, Harvard University, reporter on Trusts for the American Law Institute), at page 983, Professor Scott says:

> "In the earlier days, particularly in England, trustees were not usually intended to exercise as wide powers of management and control as those which are usually intended to be conferred upon trustees today. There is a general tendency to enlarge the scope of the powers of the trustees * * *."

Further at page 985 he says:

> "Because of the reluctance of many courts to find that the trustee has powers which are not clearly expressed in the trust instrument, and because of the resulting doubts which arise as to the existence of certain powers, it is customary in well drawn trust instruments to make provisions in express words conferring upon the trustee powers which are or may become necessary or appropriate for the efficient administration of the trust. The administration of the trust may be seriously impeded not only by the lack of such powers, but also by doubts, even though the doubts are not well founded, as to the existence of the powers. * * *"

On page 1225 he makes this comment:

> "By the terms of the trust the trustee may be restricted to classes of investments narrower than those in which he would otherwise be permitted to invest. * * *"
>
> "More frequently the terms of the trust instead of restricting the trustee enlarge his powers in making investments."

At page 1238 the author further says:

> "The mere fact, however, that there is a provision in the terms of the trust authorizing the trustee to retain securities in which the testator had invested does not justify him in retaining them if such retention would be imprudent. In such a case the trustee has not only a power but a duty to sell them."

In addition to the broad power of investment and the right to retain at discretion investments of the trust estate, the trustee was vested with the power to determine whether any money or property coming into his hands should be part of the capital or corpus of the trust estate or part of the income therefrom and to apportion between such capital and income any loss or expenditure in connection with such trust estate which in his opinion should be apportioned. Such provision is customarily inserted in modern trust instruments because the receipt of liquidating dividends frequently necessitates an apportionment between principal and income since the dividend received may include both principal and income. In instances where bonds are purchased at a premium it is necessary to apportion the interest received between principal and income in order to amortize the full amount of premium paid prior to the maturity of the bond.

All the powers aforementioned appear in the modern conventional trust instruments, and as a matter of fact many trust companies in the metropolitan centers of this country refuse to accept the trusteeship under trusts unless

they contain such powers which they consider both conventional and necessary. Consequently the Court of Appeals for the Eighth Circuit was in error when it concluded that petitioner wanted to avoid the restraints of a conventional fiduciary-holding of property. That the petitioner vested the trustee with broad powers of management so that the trustee might apply his personal skill and productive capacity, as an income and accumulation factor, in conjunction with the property is not a proper basis for making the income therefrom taxable to him. There is no right to assume that such powers would only serve a purpose in petitioner's hands and not in the hands of the successor. The trusts were created to last during the lives of petitioner's children and therefore in the natural course of events it is to be presumed that such trusts would continue for a considerable length of time after petitioner's death.

The Court of Appeals in this case emphasized the power vested in the trustee to pay over to the primary beneficiary all or such portion of the net income of the trust as the trustee in his uncontrollable discretion should think it advisable or necessary for the comfort, support, education or ease of such beneficiary and to pay over to the primary beneficiary all or such portion of the corpus of the trust as the trustee should deem advisable or necessary for the comfort, support, ease, care or education of the primary beneficiary. These provisions restrict the trustee as to the purposes for which he can make distribution and limit the trustee as to the amounts he can distribute for those purposes.

No matter how broad the discretion be that is vested in the trustee, the trustee is under certain legal restrictions as to the exercise of that discretion and in exercising same must only have the beneficiary's interest at heart. He cannot disregard the purposes of the trust no matter how broad the language of the trust instrument may be

and is personally responsible for any excess or any disregard of the trust purposes. Where a trust instrument provides for distribution or accumulation, he cannot act capriciously, nor can he make arbitrary distributions in utter disregard of the purposes of the trust. He must have the interest of all of the beneficiaries in mind.

2 Scott on Trusts, Sections 187.3, 187.4 and 187.5.

The Circuit Court of Appeals, Second Circuit, in a recent opinion in Helvering v. McCormack, 135 Fed. (2d) 294, pointed out the legal restrictions that rest upon a trustee irrespective of the breadth of the discretion vested in the trustee. The opinion was written by Judge Learned Hand. The trustee in that case was to apply to the use of the child so much of the net income as in the sole and absolute discretion of the trustee might be necessary and proper for the maintenance, education and well-being of the child and the balance of the net income was to be accumulated for the benefit of the child. The instrument provided that the discretion granted should be subject to no other control than that of the judgment of the trustee and neither the child nor any other person on her behalf was to have any power to control the exercise of such trustee's discretion or to compel him to make any other application than that which he might decide upon. The court held that the power to apply the income for the maintenance, education and well-being of the child did not give the trustee power to make gifts. The prospective income was much more than enough for the child's maintenance and the intention was not only to provide for that, but also to accumulate the residue as an investment. Said the Court, l. c. 297:

> "The copious verbiage with which the taxpayer hedged about the exercise of his powers as trustee against any revision by a court, may have extended his power beyond the limit of his paternal duty, but it did not set him free to deplete the accumulations by

any extravagance that whim or caprice might suggest. He had an opposing duty not to defeat the other purpose for which he had created the trust; to accumulate the income so far as it was not necessary for the child's maintenance. And this duty was particularly exacting, since the exercise of the power would relieve himself pro tanto of his duty as parent. Indeed if there had been no limit, he would have set up no trust whatever; the whole transaction would have been mere mummery. A court of equity will not allow such ancillary provisions to strangle the life and purpose of the transaction in chief."

The Court of Appeals for the Eighth Circuit handed down its opinion in the case of Stockstrom vs. Commissioner of Internal Revenue on March 23, 1945 and in the case of Funsten vs. Commissioner of Internal Revenue on April 23, 1945, the day on which it handed down its decision in the case at bar. The same issues were involved in the Stockstrom case as in the case at bar. Similar issues were involved in the Funsten case. A petition for writ of certiorari has been filed in this court in the Stockstrom case and we understand that a similar petition will also be filed in the Funsten case in the very near future. Judge Sanborn, in his concurring opinion in the Stockstrom case, expressed his dismay because courts which are required to determine such controversies as are present in the case at bar must express opinions which are obviously little more than guesses. Witness the following quotation:

"The Tax Court decided that the income of the trust created by Louis Stockstrom was his income for purposes of taxation, under the doctrine of Helvering v. Clifford, 309 U. S. 331, regardless of the fact that he could not recapture either trust income or trust principal. The basis for the decision is that Stockstrom, as donor-trustee, retained such broad powers of control and distribution over trust corpus and income that the income was taxable to him, although he could have none of it for his own use. I think the Tax Court might well have decided this case in favor of the taxpayer, but

the standard for determining to whom the income was taxable is presently so vague and indefinite that I have no conviction as to whether the decision of the Tax Court is, as a mater of law, right or wrong. I therefore concur. I think it is unfortunate that courts which are required to determine such controversies as this must express opinions which are obviously little more than guesses. The number of cases in which the doctrine of Helvering v. Clifford, supra, is invoked indicates the difficulty which the Bench and Bar are having in applying that doctrine. See Shepard's United States Citations on 309 U. S. 331."

This quotation indicates how essential it is that the points of law involved in this case be clarified by this Court. The fact that the Court of Appeals for the Eighth Circuit was called upon to decide three cases involving these points of law within a short time leads to the conclusion that there are many cases throughout the country involving the same questions.

CONCLUSION.

For the reasons hereinbefore stated, it is respectfully submitted that this Court should grant the writ of certiorari prayed for.

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 108

HARRY EDISON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 44–52) are not reported. The opinion of the Circuit Court of Appeals (R. 66–77) is reported at 148 F. 2d 810.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 23, 1945. (R. 78.) The petition for a writ of certiorari was filed June 5, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Tax Court erred in holding that, under Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code, petitioner, the grantor, is taxable on the income from two long-term trusts under which he retained broad administrative powers over the trust corpora and such control over the distribution of trust income and corpora as enabled him to shift beneficial interests in the trusts as between members of his family group.

STATUTES AND REGULATIONS INVOLVED

The applicable statutory provisions are set forth in the Appendix, *infra*, p. 17.

STATEMENT

The facts as summarized by the Tax Court (R. 44–48) are as follows:

Petitioner is the father of two children, Sidney J. Edison, born August 1, 1915, and Edna L. Edison, born June 15, 1920. The son has lived in New York City since 1935, and was married in 1940. During the taxable years, 1938 to 1941, inclusive, the daughter was unmarried and lived with her parents in St. Louis. (R. 45.)

On May 24, 1938, petitioner executed two irrevocable trusts, one for the benefit of each child, with himself as sole trustee. The corpus of each trust consisted of 2,500 shares of common stock of Edison Brothers Stores, Inc., and, in addition, he transferred to the trust for his daughter 25

shares of common stock of Mercantile Commerce Bank and Trust Company of St. Louis. On June 18, 1940, petitioner added to the corpus of the trust for his son 2,500 additional shares of common stock of the Edison Company, and on December 16, 1941, he added to the daughter's trust an additional 2,000 shares of that stock. (R. 45.)

On May 24, 1938, just prior to the transfer to the two trusts of the 5,000 shares originally constituting the trusts, petitioner owned 40,576 shares ot the common and 50 shares of the preferred stock of the Edison Company, out of 385,490 shares of common and 60,000 shares of preferred stock then outstanding. On June 18, 1940, just prior to the transfer of the additional 2,500 shares to the son's trust, petitioner owned 35,301 shares of common stock and 50 shares of preferred. On December 16, 1941, just prior to the transfer of the additional 2,000 shares to the daughter's trust, petitioner owned 32,876 shares of common and 50 of preferred. The stock was listed on the New York Stock Exchange. (R. 45.)

During the taxable years, 1938 to 1941, inclusive, petitioner was the president and a director of the Edison Company, which is a Delaware corporation engaged in the operation of retail shoe stores throughout the United States, with principal offices in St. Louis. (R. 44.) Petitioner's salary, the amount of dividends received from that corporation, and his net income disclosed by his

income tax returns for the years in question, were as follows (R. 44):

Year	Salary	Dividends	Net Income
1938	$33,915.05	$45,925.00	$76,368.27
1939	35,915.05	44,420.00	75,737.48
1940	32,323.54	50,576.50	80,654.43
1941	32,323.54	55,014.20	116,430.44

Petitioner reported the gifts to the trusts at the following values: The 2,500 shares of Edison stock given to each trust in 1938 at $25,000; the 2,500 shares given to the son's trust in 1940 at $27,500; and the 2,000 shares to the daughter's trust in 1941 at $27,000. (R. 45.)

Under each trust petitioner's wife and two brothers were named as successor trustees in the event of petitioner's death or resignation, or his refusal or inability to act, as trustee, but petitioner reserved unto himself, at any time and from time to time during his lifetime, the right and power to designate a trustee or trustees to act in lieu of the named successor trustees. (R. 14.)

Each of the two trusts contained spendthrift clauses and the following provision (R. 47–48):

> 3. The Trustee shall hold, possess, manage and control the said trust estate and every part thereof, with full power to sell, transfer, convey, dispose of, rent, lease, mortgage, pledge, encumber, invest, and reinvest the same, upon such terms and in such manner as to the said Trustee shall seem meet and proper; to receive, collect, sue for and recover the principal of the

same, and the rents, dividends, interest, income, issues and profits thereof.

It is not intended to limit the Trustee in investing the assets of the trust estate to what are commonly denominated as "legal investments for trustees", but on the contrary to give said Trustee full and plenary powers of investment such as he would possess if he were the absolute owner of the "trust estate" in his private individual capacity.

The Trustee is hereby given full power and authority to invest and reinvest all or any part of the said trust estate which may come into his hands, in such a manner and in such bonds, stocks, notes, real estate mortgages or other securities or other property, personal or real, and upon such terms and for such length of time, as to the Trustee shall seem meet and proper; it being intended hereby to give unto the said Trustee full and complete authority to hold, possess, manage, control, sell, convey, dispose of, encumber, lease, invest and reinvest the whole and every part of the said trust estate, according to his sole judgment and discretion, and his powers and authority so to do shall not be limited or restricted to securities of the character authorized or permitted as suitable for the investment of trust funds by statutes or decisions of courts pertaining thereto or by any implication therefrom.

The Trustee shall have full power without accountability for loss (whether through

depreciation in value or otherwise), to retain at his discretion as investments of the trust estate any or all property, personal or real, that may come into his hands either at the beginning of this trust or at any time thereafter.

The Trustee shall have the power to determine whether any money or property coming into his hands shall be part of the capital or corpus of said trust estate or part of the income therefrom and to apportion between such capital and income any loss or expenditure in connection with such trust estate which in his opinion should be apportioned in such manner and division as to him may seem just and equitable.

The Sidney J. Edison trust indenture provided that the trustee, during the lifetime of the son, Sidney, should, in quarterly or other convenient installments, pay over to him all or such portion of the net income of the trust as the trustee in his uncontrollable discretion shall think advisable or necessary for his comfort, support, education, or ease, or that the trustee should, either directly or through some person selected by him for that purpose, use or apply all of such net income or so much thereof as in his uncontrollable discretion he shall deem sufficient for the comfort, support, education or ease of the son. Any portion of the income not thus paid over, used or applied was to be added to the corpus of the trust fund. (R. 46.)

Similar provisions authorized encroachment upon the corpus of the trust in such amounts as the trustee, in his uncontrollable discretion, should deem advisable or necessary for the greater ease or comfort of Sidney, or for his business training, or to help him start in business or some other vocation or profession, or for his education, maintenance or care. If all of the corpus is thus paid, used or applied, the trust is to cease and terminate. (R. 46; see also R. 9.)

Provision was made for the continuance of the trust after the death of Sidney. (R. 47.) If Sidney died leaving issue, the trust fund was to be held for his child or children *per stirpes,* until each reached the age of 21 years. Until such time, the trustee could, in his discretion, use the trust income from the share of each such child for the child's support, benefit, education, ease or comfort. If the child died before reaching 21 years, the portion held in trust for him was to go to his heirs pursuant to the intestacy laws of Missouri. On the other hand, if Sidney died without issue, the trust fund was to be held for his sister Edna during her lifetime, during which both income and corpus could be paid out to her in the same manner as it could be paid to Sidney before that time, and at her death her issue were to take in the same manner as any issue of Sidney would have taken. If Edna predeceased

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Sidney, her issue were to take as if she had survived Sidney and then died. If Edna predeceased Sidney and neither left issue, the whole was to go to Sidney's heirs under the intestacy laws of Missouri. (R. 9–12.)

The trustee had power to determine whether any money or property coming into his hands should be part of the corpus of the trust or part of the income therefrom. (R. 13–14.)

The trust for petitioner's daughter Edna differed from that for Sidney only in the following material respects: It provided that until she shall attain her majority, "the Trustee shall permit the net income of said trust to accumulate and as it accumulates it shall become part of the corpus of the trust." After she attained her majority, the net income was to be distributed to her under provisions which were the same as those set out in the trust for Sidney. As in Sidney's trust, provision was made for the continuance of the trust after her death, with or without issue, with Sidney and his issue named as alternative beneficiaries in the event Edna died without issue. (R. 17–23, 48.)

Petitioner has acted as sole trustee since the establishment of the trusts and, as such, has filed fiduciary income tax returns for each of the years here in question, reporting the following data (R. 46):

SIDNEY J. EDISON TRUST

	Dividends received	Income distributed	Undistributed income	Tax paid
1938	$2,510.00		$2,510.00	$96.40
1939	3,175.00	$1,400.00	1,757.35	66.29
1940	6,310.00	2,132.06	4,167.07	181.90
1941	8,568.00	[1] 3,166.25	5 349.98	672.50

[1] Distributed to beneficiary.

EDNA L. EDISON TRUST

	Dividends received	Undistributed income	Tax paid
1938	$2,585.00	$2,585.00	$99.40
1939	3,400.00	3,400.00	131.27
1940	4,110.00	4,110.00	174.75
1941	5,638.00	5,638.00	712.65

The income received by petitioner as trustee of these trusts was kept by him in separate bank accounts. (R. 46.)

Petitioner retained such control over the property of the trusts as to remain substantially the owner thereof for tax purposes. (R. 48.)

On the basis of these facts, the Tax Court held petitioner taxable on the income from the trusts under the doctrine of *Helvering* v. *Clifford,* 309 U. S. 331. (R. 48–52.) The Circuit Court of Appeals affirmed the decision of the Tax Court. (R. 66–77.)

ARGUMENT

This case, like *Stockstrom* v. *Commissioner,* 148 F. 2d 491 (C. C. A. 8th) and *Hamburger* v. *Commissioner,* 147 F. 2d 856 (C. C. A. 6th), similar cases pending on petitions for writs of certiorari Nos. 96, 94, October Term, 1945), is governed by

the doctrine established by this Court in *Helvering* v. *Clifford,* 309 U. S. 331. See also *Helvering* v. *Stuart,* 317 U. S. 154; *Hormel* v. *Helvering,* 312 U. S. 552; *Helvering* v. *Richter,* 312 U. S. 561. Application of the *Clifford* doctrine to the particular circumstances of the case called for an evaluation of numerous evidentiary facts bearing upon the extent of the control retained by petitioner, the grantor, over the trust corpus and income, in order to determine whether, in substance, he was still to be treated as the owner for the purposes of Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code (Appendix, *infra,* p. 17). This Court has indicated that the process of applying the *Clifford* doctrine to specific facts is peculiarly within the province of the Tax Court. *Dobson* v. *Commissioner,* 320 U. S. 489, 491, rehearing denied, 321 U. S. 231; *Helvering* v. *Clifford, supra,* pp. 336, 338; *Harrison* v. *Schaffner,* 312 U. S. 579, 583–584; *Helvering* v. *Stuart, supra,* pp. 167, 169; see also *Hormel* v. *Helvering, supra,* p. 560; *Helvering* v. *Richter, supra,* p. 562. The court below recognized this (R. 77) and stated (R. 76):

> * * * we cannot say—as we could not in the *Stockstrom* and *Funsten* cases—that the Tax Court's appraisal of petitioner's powers of control here, in the light of the relationships involved, the donor's general scheme of family economics, and the results

> to him in the particular situation, is without a rational basis of taxability under section 22 (a).

Under the circumstances, affirmance of the Tax Court's decision was the only proper course. *Trust u/w of Bingham* v. *Commissioner,* No. 932, last Term, decided June 4, 1945, not yet reported; *Commissioner* v. *Estate of Bedford,* No. 710, last Term, decided May 21, 1945, not yet reported; *Commissioner* v. *Scottish American Co.,* 323 U. S. 119; *Dobson* v. *Commissioner, supra.*

Petitioner is incorrect in asserting (Br. 26–27) that the decision below is in conflict with Sections 161, 162 and 167 (c) of the Internal Revenue Code (26 U. S. C., Sec. 161, 162 and 167). Although those sections relate to the taxation of trust income, as petitioner states, it is of the very essence of the *Clifford* doctrine that taxability to the grantor may nevertheless be predicated upon Section 22 (a). See *Helvering* v. *Clifford, supra,* pp. 337–338; *Helvering* v. *Stuart, supra,* pp. 168–169; *Helvering* v. *Wood,* 309 U. S. 344; *Hormel* v. *Helvering, supra; Brown* v. *Commissioner,* 131 F. 2d 640 (C. C. A. 3d), certiorari denied, 318 U. S. 767; *Hall* v. *Commissioner* (C. C. A. 10th), decided July 2, 1945 (1945 P–H, par. 72,608).

Contrary to petitioner's contention (Br. 20–24), there is no conflict in Circuit Courts of Appeals decisions. None of the cases petitioner cites in-

volved trusts under which the grantor retained power to shift beneficial interests in the trust.[1] In the instant case petitioner had complete control over the distribution of both income and corpus during the lifetime of the primary beneficiary, as well as control over the distribution of income afterwards, could pay out such amounts to the primary beneficiary as he saw fit and thus decrease or increase the shares of the remaindermen and primary beneficiary or cut off either alto-

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[1] In *Commissioner* v. *Armour*, 125 F. 2d 467 (C. C. A. 7th), and *Commissioner* v. *Branch*, 114 F. 2d 985 (C. C. A. 1st), the trust income was currently payable to the beneficiary and the grantor had no power to accumulate it. In *Armstrong* v. *Commissioner*, 143 F. 2d 700 (C. C. A. 10th), the trust income was to accumulate and become part of the corpus and the grantor had no power to pay it out before the termination of the trust. In *Commissioner* v. *Katz*, 139 F. 2d 107 (C. C. A. 7th), and *Jones* v. *Norris*, 122 F. 2d 6 (C. C. A. 10th), the grantor had power to accumulate the income or pay it out but, if accumulated, the same beneficiary got it later, in the first case when the beneficiary reached the age of 25 years and in the second case at the termination of the 20-year trust. In *Phipps* v. *Commissioner*, 137 F. 2d 141 (C. C. A. 2d), the grantor had discretionary control over the income, but the court stated that the grantor's wife, who was a beneficiary and had an adverse interest, was one of the trustees and the grantor could control the income only through a disregard of the purposes of the trust—a disregard which would result in judicial intervention. Thus, the decision was predicated on the view that the local courts would have been an effective check upon the grantor's control of the income.

gether.[2] This distinction is an important one (see *Foerderer* v. *Commissioner,* 141 F. 2d 53 (C. C. A. 3d)), for, as this Court has stated, the power to dispose of income is equivalent to ownership of it and the exercise of that power to procure payment to another is the enjoyment and realization of the income by him who exercises it. *Helvering* v. *Horst,* 311 U. S. 112, 118; see also, *Corliss* v. *Bowers,* 281 U. S. 376, 378; *Harrison* v. *Schaffner,* 312 U. S. 579, 581. Moreover, in four of the cases cited by petitioner the decision of the Tax Court was affirmed [3] and, consequently, the cases could, at most, be but examples of inconsistencies of the Tax Court rather than conflicts justifying review by this Court; and, as the court below pointed out, there is no such inconsistency (R. 76–77). In addition, two of the cases,[4] one in which the Tax Court's decision was reversed, are decisions of the Circuit Court of Appeals for the Tenth Circuit which in a later decision (*Hall* v. *Commissioner, supra*) specifically recognized that the power to shift ben-

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[2] In the Edna Edison trust the income was to be accumulated during Edna's minority and added to principal, but the income could be paid out to Edna as principal. (See R. 70–71.)

[3] *Commissioner* v. *Armour, supra; Commissioner v. Branch, supra; Commissioner* v. *Katz, supra; Jones* v. *Norris, supra.*

[4] *Jones* v. *Norris,* supra; *Armstrong* v. *Commissioner, supra.*

eficial interests results in economic gain to the grantor and warrants taxing the grantor on the trust income. The conclusion in the *Hall* case that the grantor was not taxable on the trust income resulted from the fact that the court found no power in the grantor to shift beneficial interests, the accumulated income being payable to the primary beneficiary 15 years after the creation of the trust.

Nor is petitioner correct in asserting (Br. 18–20) that the decision below conflicts with the decision of this Court in *Helvering* v. *Stuart, supra.* While the Court stated in that case that "economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme" (p. 168), it was also stated that (pp. 168–169):

> economic gain for the taxable year, as distinguished from the non-material satisfactions, may be obtained through a control of a trust so complete that it must be said the taxpayer is the owner of its income. So it was in *Helvering* v. *Clifford,* 309 U. S. 331, 335, 336. Cf. *Helvering* v. *Fuller,* 310 U. S. 69, 72 note 1, 76.

The decision below, as already stated, is based on the conclusion that taxpayer did retain such control of the trust as, in substance, to constitute himself the owner of it. That conclusion is not

erroneous because of the impossibility of reversion to the grantor, for the *Stuart* decision makes it plain that while that is a factor pointing to divestment of control it is not conclusive. (P. 169.)

Petitioner's contention that to tax him on the income from these trusts violates provisions of the Constitution and of amendments thereto (Br. 15–18) is inapposite. He argues that it is a denial of due process of law to tax one person upon the profits and gains of another. (See Br. 18.) Here, as in the *Clifford* case, the tax is levied upon income which in substance and reality is that of this taxpayer and not of another. See *Burnet* v. *Wells*, 289 U. S. 670, 678, 679. The fact that there was an otherwise valid anticipatory assignment of income is no more material here than it was in the *Clifford* case.[5]

The case does not present an issue of law calling for review. A similar petition for certiorari was denied last term in *George* v. *Commissioner*, 143 F. 2d 837 (C. C. A. 8th), certiorari denied, 323 U. S. 778.

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[5] See also *Commissioner* v. *Harmon*, 323 U. S. 44; *Helvering* v. *Eubank*, 311 U. S. 122; *Higgins* v. *Smith*, 308 U. S. 473; *Griffiths* v. *Commissioner*, 308 U. S. 355; *Helvering* v. *Horst*, 311 U. S. 112; *Burnet* v. *Leininger*, 285 U. S. 136; *Corliss* v. *Bowers*, 281 U. S. 376; *Lucas* v. *Earl*, 281 U. S. 111.

CONCLUSION

The decision below is correct and involves no conflict of decisions or important question of law to be resolved. The petition for a writ of certiorari therefore should be denied.

Respectfully submitted.

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SEPTEMBER 1945.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C., Sec. 22.)

The provisions of Section 22 (a) of the Revenue Act of 1938, c. 289, 52 Stat. 447, are identical.

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No. 108.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1945.

HARRY EDISON,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

PETITIONER'S REPLY BRIEF.

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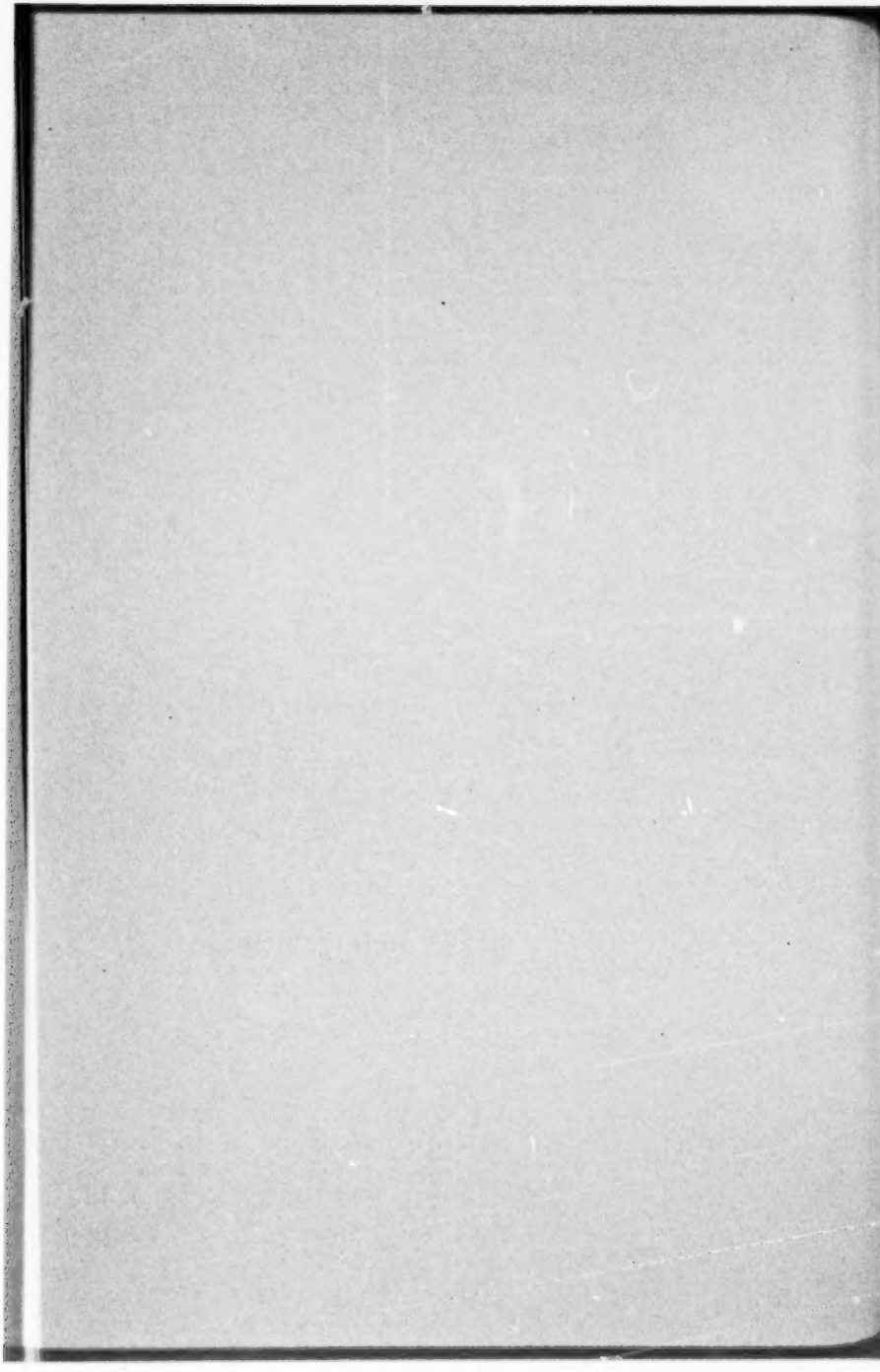

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

PETITIONER'S REPLY BRIEF.

The petitioner respectfully submits that the question presented is incorrectly stated by respondent in his brief (p. 2) when he states that the question is whether the Tax Court erred in holding that under Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code, petitioner, the grantor, is taxable on the income from two long term trusts under which he retained broad administrative powers over the trust corpora and such control

over the distribution of the trust income and corpora as enabled him to shift beneficial interests in the trusts as between members of his family group. The question presented is properly stated in the Petition for Writ of Certiorari filed herein by petitioner (pp. 8-9). The misstatement of the question by the respondent is primarily in his assertion that the taxpayer, the grantor, retained broad administrative powers over the trust corpora and such control over the distribution of the trust income and corpora as enabled him to shift beneficial interests in the trusts as between members of his family group. First, the grantor (taxpayer) only retained the right as grantor to name successor trustees to those designated by him as successor trustees in the trust instruments; all other powers were vested in the trustee. Second, there is no power even in the trustee to shift beneficial interests in the trusts as between members of grantor's family group. The primary beneficiary has a vested interest only in that portion of the income which the trustee in his discretion might deem advisable or necessary for the comfort, support, education or ease of the primary beneficiary, and in that portion of the trust corpora as the trustee in his discretion should deem it advisable or necessary to pay over for the greater ease or comfort of the primary beneficiary or for his or her business training or to help him or her start in business or some other vocation or for his or her education, maintenance or care. The broad discretion vested by the language of the trust instruments in the trustee is subject to legal restrictions which the trustee may not ignore. See the opinion of Judge Learned Hand in Helvering v. McCormack, 135 Fed. (2d) 294, discussed in Petitioner's Brief in Support of Petition for Writ of Certiorari (pp. 35-36), specifically dealing with such powers of distribution and the opinion of Justice Cardozo in Carrier v. Carrier, 123 N. E. 135, 226 N. Y. 114, wherein he used the following language:

> "His discretion was to be 'absolute and uncontrolled.' That does not mean, however, that it might be recklessly or willfully abused. He had made himself a trustee; and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of trustee. He had power to 'invest' the moneys committed to his care. He had no power, under cover of an investment, to loan them to himself. His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust. * * *"

The trustee has no right to shift beneficial interests. His duty is to pay over to those beneficiaries designated to receive same as much of the income and corpus as may be necessary for the purposes specifically stated and to retain the balance for ultimate distribution to those beneficiaries entitled to receive same. Once the need of the beneficiary to satisfy one of the designated purposes is established, there is no absolute discretion to ignore that need. The discretion vested in him only permits him to determine how much may be necessary to fill that need, and if the discretion is exercised in good faith and within reasonable limits and the result does not indicate an unreasonable, arbitrary, capricious or whimsical exercise of that discretion it will be binding, otherwise not. Courts will interfere, if necessary, to enforce a payment if the circumstances warrant. By the same token, as stated by Judge Hand, the trustee cannot ignore the rights of the remaindermen and give to the primary beneficiary that which the trust indicates should go to the remaindermen. Ergo, there is no power to shift the beneficial interests between members of the grantor's family group.

Respondent in his Brief in Opposition (pp. 11-12) states that none of the Circuit Courts of Appeals cases cited by petitioner involved trusts under which the grantor retained power to shift beneficial interests in the trust.

This refers to cases which petitioner cited in his brief where the facts were very similar and in some instances almost identical with the facts involved in the case at bar. These cases are set forth in petitioner's brief (pp. 20-26). This corresponds with the petitioner's contention that these cases cited by him, like the case at bar, do not involve the shifting of beneficial interests.

In trying to distinguish the cases cited by petitioner, respondent states with reference to Commissioner v. Armour, 125 Fed. (2d) 467 (C. C. A. 7th), that the trust income was currently payable to the beneficiary and the grantor had no power to accumulate it, but overlooks the fact that the grantor-trustee was charged to pay to her daughter all the income and such part of the principal as should be necessary during the daughter's lifetime for the daughter's support, maintenance and comfort.

With reference to Armstrong v. Commissioner, 143 Fed. (2d) 700 (C. C. A. 10th), wherein the Tax Court was reversed, respondent states that the trust income was to accumulate and become part of the corpus and the grantor had no power to pay it out before the termination of the trust. He overlooks that provision of the trust instrument involved in that case which, after providing that the entire net income was to be accumulated and become a part of the corpus, further provided as follows:

> "All income or principal shall be payable and deliverable only and personally to the Beneficiaries hereunder, and said property, or any portion thereof, or income therefrom, may be distributed to said Beneficiaries in equal portions at any time deemed advisable by the Trustee."

These provisions are found in the opinion of the Tax Court in Murphy Shannon Armstrong, 1 T. C. 1008, l. c. 1010-1011.

With reference to Commissioner v. Katz, 139 Fed. (2d) 107 (C. C. A. 7th), respondent states that the grantor had

power to accumulate the income or pay it out, but having accumulated the same, beneficiary got it later when he reached the age of 25 years. That is not so. The trust was created to last during the grantor-trustee's lifetime. The trust income could be accumulated or distributed in the trustee's discretion to his son during the son's lifetime and in the event the son died before termination of the trust, then to the son's lawful issue and in the event the son died without surviving issue before the termination of the trust, then in equal shares to petitioner's wife and petitioner's issue. Upon the termination of the trust the entire trust estate, including the accumulated net income, was to be distributed to petitioner's son, provided he had attained the age of 25 years, otherwise it was to be held until he attained the age of 25 years. In the event petitioner's son had predeceased petitioner, then it was to go to the son's lawful issue and if the son had no lawful issue then living, it was to go to petitioner's wife and petitioner's issue in equal shares. These facts parallel those in the case at bar, except that in the Katz case the trust instrument did not specify the purposes for which the trustee in his discretion might pay over part or all of the income, whereas in the case at bar there is. And further in the Katz case there was no right to encroach upon the principal, whereas in the case at bar the trustee has the right to encroach upon the principal for the purposes specifically stated. See the opinions in Commissioner v. Katz, 139 Fed. (2d) 107, l. c. 108-9, and 46 B. T. A. 187, l. c. 190-191.

Respondent attempts to distinguish Jones v. Norris, 122 Fed. (2d) 6 (C. C. A. 10th), by pointing out that the grantor had power to accumulate the income or pay it out, but if accumulated the same beneficiary got it later at the termination of the twenty year trust. That is not necessarily so. If the primary beneficiary died before the termination of the trust, the issue of the primary beneficiary got it under the terms of the trust.

The distinction that respondent attempts to make with reference to Phipps v. Commissioner, 137 Fed. (2d) 141 (C. C. A. 2nd), to-wit: that the local courts would have an effective control over grantor-trustee's exercise of his discretion to pay over or accumulate the income, supports our contention in the case at bar. The court in that case said that an arbitrary refusal on the part of the co-trustee to pay to the wife any of the income so that it would accumulate would induce the New York courts to interfere and compel the co-trustee to exercise a genuine discretion in the light of the purpose of the trust and equity would compel distribution. 137 Fed. (2d), l. c. 144.

Since the filing of the petition for certiorari in this case, the United States Court of Appeals for the Tenth Circuit handed down its decision on July 2, 1945, in the case of Hall v. Commissioner, which is in direct conflict with the decision below. Hall v. Commissioner reversed the Tax Court. The decision of the Court of Appeals is not officially reported and in order that this Court might have the benefit thereof it is printed in full as an appendix hereto. It is unofficially reported in 1945 Prentice-Hall Federal Tax Service, Paragraph 72608, and in C. C. H. Standard Federal Tax Reporter, Paragraph 9361.

In the Hall case the grantor created an irrevocable trust which was to last for fifteen years. The trust was created for the benefit of his four daughters and their issue. The grantor named himself as trustee and gave himself broad powers of administration. The Trustee was specifically authorized to distribute all of the income from the trust to the beneficiaries "in equal shares at any time in the discretion of the trustee" and in addition to the income the trustee was empowered at any time during the continuance of the trust to expend from the principal or income any sums reasonably necessary for the education and maintenance of the beneficiaries and for the "purpose of defraying the expenses of illness, emergency or other

extreme misfortune." The trust further provided that in the event of the demise of any of the named beneficiaries (daughters of the grantor-trustee) prior to the full distribution of the trust estate, the share of such beneficiary should be held for the use and benefit of her issue in equal parts under the same conditions to be expended in their behalf in the sole discretion of the trustee until the termination of the trust. It further provided that in the event of the death of all the beneficiaries without issue, the trust estate was to descend to the trustor or his wife if she survived. The grantor-trustee or his wife as immediate successor was granted "unlimited powers of investment, contract, compromise, sale, lease and otherwise. It being the intent of the trustor to grant the trustee the same power to deal with the property as trustee as the trustor has heretofore had with one limitation only," but all other successor trustees were limited in their powers of investment of trust funds to Government bonds and real estate mortgages in amounts not to exceed forty per cent of the actual value at the time of the invesment. Upon termination of the trust, distribution was to be made in accordance with the provisions hereinbefore mentioned. It was held that the grantor-trustee was not taxable with the income of the trust and the Tax Court, which found to the contrary, was reversed. The Court of Appeals, arguendo, in referring to the Stockstrom decision, points out that in the Stockstrom case the trustee was authorized in his discretion to withhold the distribution of income during his lifetime or the lifetime of the beneficiaries. This, we have seen from analysis of the other decisions, is not a controlling factor. It is a distinction without a difference.

Furthermore in the case at bar, as we have pointed out, the discretion vested in the trustee is a controlled discretion and it must be exercised for the purposes specified

in the trust. If anything at all, the facts in the Hall case were less favorable to the taxpayer than they are in the case at bar.

Respondent fails to distinguish the case at bar from a case like Commissioner v. Buck, 120 Fed. (2d) 775 (C. C. A. 2nd), where the grantor retained the power to shift beneficial interests in the trust. In Commissioner v. Buck the grantor reserved to himself during his lifetime the power at any time and from time to time to "alter or amend in any respect whatsoever" the provisions of the indenture relating to "the disposition of the income and principal of the trust estate or the separate shares into which the same may be divided, and to change any beneficial interest" thereunder. In the Buck case the Court of Appeals for the Second Circuit held that this gave the grantor the power to shift beneficial interests. In Phipps v. Commissioner, 137 Fed. (2d) 141 (C. C. A. 2nd), the Circuit Court of Appeals for the Second Circuit, which decided both cases, distinguishes the Buck case from the Phipps case, which involves facts more nearly like those present in the case at bar, and points out that in cases such as the one at bar there is no power to shift beneficial interests.

The respondent advances a rather naive argument when he states that some of the cases cited by petitioner which conflict with the decision below in this case, represent inconsistencies of the Tax Court rather than conflicts justifying review by this Court because in those cases the decisions of the Tax Court were affirmed. A simple answer is that when a Circuit Court of Appeals reviews a decision of the Tax Court involving a question of law the decision of the Appellate Court is a declaration on its part of the law and if its decision conflicts with that of another Circuit Court of Appeals a situation is presented justifying review by this Court.

The other points discussed by respondent are amply covered in petitioner's brief in support and there will be no further discussion thereof in order to avoid redundancy.

This case is a proper one for review by this Court. Trustee u/w of Bingham v. Commissioner, No. 932, last Term, decided June 4, 1945, and reported in Law. ed. Advance Opinions, Vol. 89, No. 16; Dobson v. Commissioner, 320 U. S. 489; Helvering v. Stuart, 317 U. S. 154. It involves a question of law reviewable on appeal as was recently held by the Tenth Circuit in Hall v. Commissioner, decided July 2, 1945 (1945 P.-H., par. 72608, not yet officially reported, but set out in the Appendix hereto).

Respondent points to the fact that a petition for certiorari was denied last term in George v. Commissioner, 145 Fed. (2d) 837, C. C. A. 8th, certiorari denied 323 U. S. 778. The issues in the George case were different from those involved in the case at bar and therefore the denial in that case is not a precedent to be applied in this case.

CONCLUSION.

For the reasons hereinbefore stated, it is respectfully submitted that this Court should grant the writ of certiorari prayed for.

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APPENDIX.

Joel E. Hall v. Commissioner of Internal Revenue.

(U. S. Circuit Court of Appeals, Tenth Circuit, No. 3126, July 2, 1945.)

On petition to review the decision of the Tax Court of the United States.

Angus M. Woodford for Petitioner.

John F. Costelloe (Samuel O. Clark, Jr., Sewall Key, Robert N. Anderson and Newton K. Fox were with him on the brief) for Respondent.

Before Phillips, Brattan and Murrah, Circuit Judges.

Murrah, Circuit Judge, delivered the opinion of the court.

Applying the rule in Dobson v. Commissioner, 320 U. S. 489, the precise question presented here is whether there is "warrant in the record and a reasonable basis in the law" for the judgment of the Tax Court holding income from a family trust, created by the taxpayer for the benefit of his four daughters, taxable to him as donor under Section 22 (a) of the Internal Revenue Code, as construed and applied by Helvering v. Clifford, 309 U. S. 331 [23 AFTR 1077], and subsequent decisions of this and other courts. There is no dispute concerning the facts as found by the Tax Court, and they may be summarized as follows:

On December 28, 1940, the petitioner, Joel E. Hall, an Oklahoma oil man, who estimated the value of his estate in 1941 at $350,000.00, and of his wife at $100,000.00, created an irrevocable trust, naming his four daughters bene-

ficiaries. At that time, the ages of the beneficiaries were 20, 19, 17 and 14 respectively. The trust was created by the petitioner transferring to himself as trustee certain oil and gas producing properties having an aggregate value of $35,000.00, and subsequently other producing properties valued at $25,000.00. The trust provided that the petitioner as trustee should hold and manage the properties involved and collect the proceeds therefrom. After deducting the necessary and ordinary expenses of the trust, the trustee was specifically authorized to distribute all of the income from the trust to the beneficiaries "in equal shares at any time in the discretion of the trustee", and in addition to the income the trustee was empowered at any time during the continuance of the trust to expend from the principal or income any sums reasonably necessary for the education and maintenance of the beneficiaries, and for the "purpose of defraying the expense of illness, emergency or other extreme misfortune".

The trust further provided that in the event of the demise of any of the named beneficiaries prior to the full distribution of the trust estate, the share of such beneficiary should be held for the use and benefit of her issue in equal parts under the same conditions, to be expended in their behalf in the sole discretion of the trustee until the termination of the trust. In the event, and only in the event, of the death of all beneficiaries without issue, the trust estate was to descend to the trustor, or his wife if she survived. The trustor's wife was designated as successor trustee if he died prior to the termination of the trust, and in the event of the death of both, other successor trustees were named. The trustee, or his wife as immediate successor, was granted "unlimited powers of investment, contract, compromise, sale, lease and otherwise. It being the intent of the trustor to grant the trustee the same power to deal with the propery as trustee as the

trustor has heretofore had with one limitation only". But all other successor trustees were limited in their powers of investment of trust funds to government bonds and real estate mortgages on city property in amounts not to exceed 40% of the actual value at the time of investment. Neither the trustee nor his wife as successor trustee was to receive any compensation for their services, and all other successor trustees were to receive 10% of the net income from the trust property. At the expiration of fifteen years, the trust terminated, and the trustee was directed to pay over and distribute to the beneficiaries all the undistributed trust assets.

The approximate annual income from the trust for the years 1940, 1941 and 1942 was $10,000.00 to $12,000.00. The petitioner kept separate books for each of the beneficiaries; he never used or borrowed any of the trust funds for himself, and did not expend any of it for the maintenance and education of the beneficiaries. The only withdrawals against the trust during 1941 were two checks issued by the trustee for the purchase of Series E Government Bonds in the amount of $750.00 for each of his two eldest daughters. The bonds were purchased in their names and kept in the petitioner's lockbox.

For the taxable year 1941, petitioner filed his individual income tax return and separate returns for each of the beneficiaries. The Commissioner determined that the income from the trust was taxable to the petitioner individually and assessed a deficiency accordingly. On petition for review to the Tax Court, the petitioner apparently conceded that the portion of the trust income attributable in equal shares to his two minor children was taxable to him individually, but contended that the portion of the trust income allocable in equal shares to his two adult children was taxable to them as separate income.

Applying the test "whether the rights of the petitioner

in and to the trust corpus and the income therefrom are such as to constitute the income his income within the meaning of Section 22 (a)", the Tax Court held that taking into account the family relationship, the only practical result of the trust was to effect a division of the income of petitioner for income tax purposes. The Court reasoned that although the possibility of reverter was "rather remote", yet petitioner did have discretionary power to distribute or withhold the income; to invade the principal for the purpose of educating and maintaining the children, or for defraying the expenses of illness or other extreme misfortune, and also retained for himself and his wife as successor trustee the power to use the trust property in his oil well drilling ventures, or in any venture in which he or anyone else might be engaged, while denying that power to all other successor trustees. In view of these controls the Court, quoting from the Clifford case, observed that it is "hard to imagine that [Petitioner] felt himself the poorer after this trust had been executed, or if he did, that it had any rational foundation in fact."

As we have said, the pertinent facts in our case are not in dispute, nor is the abstract principle of law in doubt—we have only the application of stated facts to a settled and accepted rule of law. Whether that process is judicial in the sense that it is open to review on appeal from the Tax Court, or merely a factual finding binding here, is open to some doubt. See Dobson v. Commissioner, supra.[1] Following the admonitions in the Dobson case, we said in Armstrong v. Commissioner, 143 F. (2d) 700 [¶ 62,668 P-H 1944 Fed.], that "the finding of the Tax Court that petitioner in substance was the owner of the trust property is in our view not a finding of fact, but a conclusion of law, and the decision in the case turns upon the correctness of that conclusion"—this for the obvious reason that tax-

1 See also The Strange Ways of Law and Fact, Randolph E. Paul, 57 Harv. Law Rev. 753.

ability turns directly upon the answer to that question. It would seem therefore that whether there is "warrant in the record and a reasonable basis in the law" for the legal conclusion of the Tax Court, based upon undisputed facts, is a judicial question committed to this court for review. At least if we have any real function or province in connection with the statutory review of this class of cases, it must relate to the process of applying known and accepted facts to legal concepts. Cf. Commissioner v. Heininger, 320 U. S. 467 [31 AFTR 783]. Of course we accord great weight to the expertness of the Tax Court in a specialized field, but the strong dissent in this case clearly demonstrates the contrariety of views among judges of that Court concerning the application of varying facts to the recognized principle of law. See also Scherer v. Commissioner, 3 T. C. 776.

The sweep of Section 22 (a), as construed by the courts, is based upon the legislative purpose to tax "* * * gains or profits and income derived from any source whatever". Few judges or courts longer deny the soundness or the salutary effect of the Clifford doctrine as the effectuation of that Congressional purpose, but as in all cases involving the drawing of lines based upon factual variations, the difficulty arises when we come to apply the facts to the law in arriving at our legal conclusion. Our conclusion in each case must rest upon the thesis that "economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme". Helvering v. Stuart, 317 U. S. 154, 168 [29 AFTR 1209]. And that the power to command the trust income is equivalent to the taxable enjoyment thereof. Harrison v. Schaffner, 312 U. S. 579 [25 AFTR 1209]. See also Helvering v. Horst, 311 U. S. 112 [24 AFTR 1058]; Helvering v. Eubank, 311 U. S. 122 [24 AFTR 1063]; Mertens, Law of Federal Income Taxation, Sec. 18.02.

While we may ignore the technical niceties of the law of trusts in the determination of what constitutes the realization of taxable gain under Section 22 (a), Helvering v. Clifford, supra; Losh v. Commissioner, 145 F. (2d) 456 [¶ 72,278], we may not ignore that which Congress has recognized unless fully justified by the realities of the particular case. By Sections 161, 162, 166, and 167 of the Internal Revenue Code, Congress has distinctly recognized a trust as a separate taxable entity, and has provided for the imposition of a tax on the trust income as such. The statute in meticulous detail has specified the conditions on which trust income is taxable to the donor, and the specifications contained in Sections 166 and 167 do not by their terms deny the right of a father to create a trust for the benefit of his family, and to retain unto himself broad powers of management and control over the corpus and income so long as he does not retain the power to revest the corpus or revert the income to his own economic benefit. See Helvering v. Wood, 309 U. S. 344 [23 AFTR 1074]. But the Clifford doctrine is admittedly a judicial extension of the statutory standards for the determination of the question of ownership of trust income for tax purposes. Jones v. Norris, 122 F. (2d) 6 [27 AFTR 786].[2] Although the Clifford case avoided the recognition of a trust for income tax purposes under Sections 161, 166 and 167, it did not repudiate the family trust as a separate taxable entity. See also Helvering v. Stuart, supra. It did, however, lay emphasis on family solidarity as a circumstance which called for close scrutiny in the determination of the question whether the donor-trustee should be treated as the real owner for purposes of taxation. The Supreme Court in the Stuart case, and this court in Hogle

[2] Cf. Clifford case and the Wood case, decided the same day in opinions by Justice Douglas, who pointed out the distinction between taxability under Sections 166 and 22 (a).

v. Commissioner, 132 F. (2d) 66 [30 AFTR 529], held that trust income which, under the terms of the trust could be used to discharge the parental obligations of the donor-trustee to his minor children beneficiaries, was taxable to him individually. But Congress by Section 134 of the Revenue Act of 1943, subsection (c) I. R. C., Section 167, promptly repudiated this treatment of Sections 22 (a) and 167, by providing retroactively that merely because trust income could in the discretion of the grantor-trustee be applied to the support and maintenance of a beneficiary whom the grantor was already legally obligated to support, is not taxable to him except to the extent that such income was so applied or distributed. See Merten's, Sec. 37.21, 44 Sup.

We have said that broad and unlimited powers of management reserved to the donor-trustee of a family trust, do not necessarily spell taxable ownership of trust income under Section 22 (a), unless by such controls he is enabled to realize the economic benefit therefrom. Jones v. Norris, supra; Armstrong v. Commissioner, 143 F. (2d) 700 [supra]. In that connection, it has been held that the power to shift the income from one beneficiary to another is the realization of economic gain within the statute. Commissioner v. Buck, 120 F. (2d) 775 [27 AFTR 509]; Helvering v. Elias, 122 F. (2d) 171 [27 AFTR 821], cert. denied 314 U. S. 692; Warren v. Commissioner, 45 BTA 379, affir. 133 F. (2d) 312 [30 AFTR 770]; Brown v. Commissioner, 131 F. (2d) 640 [30 AFTR 440], cert. denied 318 U. S. 767; Stockstrom v. Commissioner, 3 T. C. 255, affir. 148 F. (2d) 491 [¶ 72,465]. See also Miller v. Commissioner, 147 F. (2d) 189 [¶ 72,376].

The Tax Court cited the Buck case, supra, as applicable to the powers of control and management retained by the trustee in this case, and to bring it within the rationale of

that case, appellee argues that the trustee was empowered "to shift the income among the various beneficiaries under broad administrative powers over the trust corpus and income". But we can find no such powers in a trust instrument which specifically provides that all of the net income from the investments made by the trustee "may be distributed to the beneficiaries * * * in equal shares at any time in the discretion of the trustee". Cf. Small v. Commissioner, 3 T. C. ... In our case the trustee was authorized in his discretion to withhold the distribution of income, but he could not shift it from one beneficiary to another—nor could he hold it during his lifetime or the lifetime of the beneficiaries as in the Stockstrom and Miller cases, and cases cited therein. The trustee could not change the beneficial interest of the beneficiary; he was not authorized or empowered to "reduce or obliterate" the share of principal or interest originally allocated to any of the beneficiaries. At the expiration of the trust, fifteen years from the date of its execution, the corpus and economic income must be distributed to the beneficiaries or their issue. It is only on the remotest contingency that the trustor could be revested with either the corpus or the income. Cf. Leonard v. Commissioner, 4 T. C. No. 149; Stuart v. Commissioner, on remand from the Supreme Court, 2 T. C. 1103; McCutchin v. Commissioner, 4 T. C. No. 146.

It was the intention of the trustor to grant to himself as trustee the same power to deal with the trust property as he possessed before the establishment of the trust, and it may be argued that this unusual grant of power enabled the trustee to invest the trust funds for his personal advantage and benefit, thereby vitiating the trust entity and realizing the economic gain necessary to produce a taxable income under Section 22(a). It may be conceded that the power to invest trust funds for the trustee's personal ad-

vantage and benefit is equivalent to the taxable enjoyment of the trust income, but we cannot say that the absolute power of the trustee to deal with the trust property as if it were his own empowers him to use it for his own personal advantage and gain. Such a construction of the trust instrument would be contrary to the fundamental principles of equity which guide trustees and protect trust property. In the language of Justice Cardozo in Carrier v. Carrier, 123 NE 135, "His discretion was to be absolute and uncontrolled. That does not mean however that it might be recklessly or willfully abused. He had made himself a trustee; and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of trustee. He had power to invest the moneys committed to his care. He had no power, under cover of an investment, to loan them to himself. His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust * * *". See also Estate of Benjamin Lowenstein, 3 T.C. —.

We should not place a construction upon a trust instrument which would impute culpability to the trustee, nor destroy the trust instrument itself unless no other construction is permissible. We think that the expressed intention, when considered in the light of his conventional trust obligations, put the trust property beyond his power to reap more than the satisfaction of administering property which he had conveyed in trust for the benefit of his daughters in accordance with the business judgment he had exercised in the accumulation of it. In the trust instrument, the trustor specifically expressed an intention to provide his children with an individual income for the purpose of protecting them against the hazards of his business operations, and to that end to create an irrevocable trust

for their use and benefit, and we cannot say that his administrative powers negative that intention. When viewed in this light, we are of the opinion that there is no reasonable basis for the judgment of the Tax Court and same is reversed.

Bratton, Circuit Judge, is of opinion that the decision of the Tax Court should be affirmed.